State of California

Board of Equalization
Legal Division

565.1685

M e m o r a n d u m

To: Mr. D. B. Sherman
Van Nuys Auditing

Date: June 13, 1994

From: John L. Waid
Tax Counsel

Subject: **U. S. Government Supply Contracts**
Software Licensing Agreements

I am answering your memorandum to me dated March 31, 1994 which followed up on our telephone conversation of March 29, 1994. You ask for a rationale supporting the Legal Division's conclusion that canned software packages could be purchased for resale under the Aerospace decision restrictions against transfer contained in the licensing package. You attached to your memorandum copies of my memorandum to Mr. Michael Hilbert, Audit Evaluation and Planning, in which I concluded that such packages could not be purchased for resale because the bundle of rights which the contractor was purchasing did not include the right to transfer the package; a memorandum of then-Principal Tax Auditor Glenn A. Bystrom to Assistant Chief Counsel Gary J., Jugum, dated December 31, 1991, outlining the problems of applying the Aerospace decision to canned software packages and requesting his advice in this matter; a copy of Mr. Jugum's memorandum to Mr. Bystrom dated January 14, 1992 in which he determined that the Aerospace decision applied to sales of canned software packages to permit U.S. government contractors to buy such packages ex-tax for resale to the United States; and a copy of the licensing agreement at issue, which agreement contains the following statement at Paragraph 5:

> "The Software and documentation are provided with Restricted Rights. Use, duplication, or disclosure of the Product by the Government is subject to restriction as set forth in subparagraph (c)(I)(ii) of the Rights in Technical Data and Computer Software clause at DFARS 252.227-7013 or subparagraphs (c)(1) and (2) of the Commercial Computer software- Restricted Rights at 48 CFR [FAR] 52.227-19, as applicable."

Mr. Jugum's memorandum dealt with the transfer of canned software packages and concludes that, under the FAR generally, as interpreted in Aerospace, software packages, like any other overhead item, may be purchased ex-tax for resale. The buyer gets title to the disks and other tangible personal property that constitute the physical package, and it is the right to use that

package (which is the bulk of the purchase price) that cannot be transferred. Additionally, property can always be sold even in violation of a restriction on sale. That restriction, while it may support an action for breach of contract by the manufacturer against the contractor, does not prevent the actual transfer of title. He found that Aerospace applied notwithstanding general transfer restrictions contained in the licensing agreements.

The licensing agreement here permits transfer to the government subject to the restrictions set forth in the cited regulations. FAR 52.227-19(c) may be used in a contract where the government is acquiring existing software to respect the originator's commercial restrictions on use, disclosure, or reproduction but also to assure that the Government acquires sufficient rights to fulfill the need for which the software is being acquired. (FAR 27.405(c), 27.409(k).) It does not discuss title passage. Thus, we conclude that, if the contract is subject to this clause, the title-transfer clauses contained in FAR 52.232-16 and 52.245-2 (clauses like those at issue in Aerospace), remain operative to accelerate the transfer of title to the government prior to use by the contractor.

Contracts with the Defense Department are different. Under the FAR system, each agency was empowered to issue supplements ostensibly to deal with agency-peculiar procurement situations and needs, provide necessary agency implementation procedures, and displace the agency procurement regulations which had existed before the FAR went into effect. In reality, agencies issued what amounted to separate regulations which superseded the FAR where they conflicted. As a result, the supplements still need to be consulted to see if there is any deviation from the FAR title-passage provisions. The Defense Department, in DFARS 252.227-7013(c), has provided that if the software displays a legend that it is subject to the restrictions of that provision title to the software stays with the contractor. As you note, the licensing agreement in question includes such a statement. Section 252.227-7013 overrides the general title-passage clauses in FAR, so that software packages sold subject to it are not resold to the United States under Aerospace.

JLW:es

cc: Mr. Glenn A. Bystrom (MIC:43)
Mr. Gary J. Jugum

State of California

Board of Equalization
Legal Division-MIC: 82

M e m o r a n d u m

565.1685

To : Supervisor
Audit Evaluation and Planning Section
(MIC:40)

Date: January 30, 1996

From : John L. Waid
Senior Staff Counsel

Subject: {No Permit Number]
Government Software Maintenance Contracts

I am responding to your memorandum dated December 5, 1995, requesting our advice regarding the effect of the decision in Aerospace Corp. v. S.B.E. (1990) 218 Cal.App.3d 1300 on the sale of optional maintenance agreements sold along with canned computer programs to persons contracting with the United States. You attached to your memorandum a copy of a memorandum dated October 5, 1995, to the Principal Tax Auditor from Mr. Peter R. Elash of the Torrance District Office, questioning the position of a government contractor, currently under audit, which is purchasing canned software programs for resale to the United States prior to use but buying the optional maintenance contracts tax paid.

Attached hereto is a copy of my memorandum, dated June 13, 1994, to Mr. D. B. Sherman of Van Nuys Auditing, explaining the application of the Aerospace decision to the sale of computer programs. The general principles embodied in the FAR often conflict with specific principles provided in the agency supplements to the FAR, and, to the extent that they conflict, the agency supplements control. As a result, the specific contract(s) the contractor has with the United States must be examined to determine to determine which set of title clauses control the contract.

JLW:sr

Attach.